



Bank of America Corporation
Enterprise Credit Risk
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Office of the Comptroller of the Currency
250 E Street, SW
Public Information Room, Mailstop 1-5
Washington, DC 20219
Attention: Docket No. 05-08
Via E-mail: regs.comments@ooc.treas.gov

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the
Federal Reserve System
Washington, DC 20551
Attention: Docket No. OP-1227
Via E-mail: regs.comments@federalreserve.gov

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attention: Comments
Via E-mail: comments@fdic.gov

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attention: No.2005-14
Via E-mail: Regs.comments@ots.treas.gov

Re: Proposal on the Classification of Commercial Credit Exposures

Ladies and Gentlemen:

Bank of America Corporation ("BAC") appreciates the opportunity to comment on the Federal Banking Agencies (the "Agencies") proposed changes to the classification system for commercial credit exposures (the "Framework"). BAC is one of the world's largest financial institutions, serving individual consumers, small and middle market businesses, and large corporations with a full range of banking, investing, asset management and other financial and risk-management products and services. The company provides unmatched convenience in the United States, serving 33 million consumer relationships with more than 5,800 retail banking offices, more than 16,700 ATMs and award-winning online banking with more than twelve million active users. Bank of America is the No. 1 overall Small Business Administration (SBA) lender in the United States and the No. 1 SBA lender to minority-owned small businesses. The company serves clients in 150 countries and has relationships with 98 percent of the U.S. Fortune 500 companies and 85 percent of the Global Fortune 500. Bank of America Corporation stock (NYSE: BAC) is listed on the New York Stock Exchange.

Agencies' Proposal Overview:

The Agencies request comments on proposed changes to the supervisory framework for the classification of commercial credit exposures. The classifications of commercial credit exposures are used to identify higher risk commercial loans and determine classified loan ratios. Examiners consider the aggregate

levels of an institution's classified assets in determining the "asset quality" and "capital adequacy" components of an institution's CAMELS ratings. These component ratings heavily influence an institution's overall CAMELS rating.

The current classification system dates back to 1938 with only minor revisions made over the last seventy years. The proposal would replace the current commercial credit classification categories (special mention, substandard, and doubtful) with a two-dimensional framework: one dimension that measures the risk of the borrower's capacity to meet their financial obligations (borrower rating), and a second focused on the loss severity the bank would likely incur in the event of the borrower's default (facility rating). As proposed, facility ratings would be required only for those borrowers rated default (i.e., borrowers with a facility placed on non-accrual or fully or partially charged off). For other borrowers, institutions would have the option of assigning a facility rating.

The proposal also attempts to clarify issues that have historically led to rating differences between bankers and examiners and among the regulatory agencies, e.g., split ratings (facilities that are assigned multiple ratings) and ratings for asset-based lending facilities.

Commentary:

We are pleased the Agencies are considering alternatives to the current classification system and we are pleased to offer comments regarding the proposal. As the banking industry has progressed, changes to the classification system are in order to better align the Agencies' rating system with the industry's more advanced credit risk measurement trends and the developing Basel II requirements. Over the past several years, BAC has made significant investments in developing and implementing a two-dimensional Risk Rating Methodology to: (1) improve the accuracy, timeliness, consistency and granularity of internal risk ratings, and (2) achieve compliance with the upcoming Basel II Advanced Internal Ratings Based approach requirements.

BAC supports the basic intentions of the proposal but we are concerned with the following aspects:

- Timing & Compatibility with Basel II Accord
- One Size Fits All Approach
- Borrower Rating Labels & Definitions
- Facility / Severity Ratings

These topics are addressed below along with answers to the Agencies' specific questions contained within the proposal. Bank of America is a member of the Risk Management Association (RMA) and has participated in the preparation of the comment letter of that organization, as well as the comment letter from the Clearing House Association. With some minor differences, we endorse their respective comment letters.

Timing & Compatibility with Basel II Accord:

In an effort to minimize disruption and confusion and to comply fully with the upcoming Basel II Accord requirements, we feel strongly that the timing of the implementation of any new classification framework should be after the Basel II implementation. Specifically, we do not recommend any adoption until after January 1, 2010 or when the 20% floor is lifted. A post-Basel II implementation will ensure the framework is in appropriate harmony with the related regulatory capital requirements. Specifically, within this proposal we noted several areas that should be further synchronized with the upcoming Basel II Accord provisions, including the following:

- **One Size Fits All Approach** – the Agencies’ proposal is intended to work for institutions of all sizes. However, we are not convinced that a “one size fits all” approach to the classification system is appropriate. Over the past several years, the larger, more advanced institutions have made significant investments in their risk management infrastructure and rating methodologies. Considerations should be given to a different supervisory approach for these institutions, much like the Basel II Accord allows differing capital allocation approaches for institutions of differing size and sophistication. We recognize this may add some complexity to the regulatory framework, but we believe it is appropriate.

If the proposal were adopted as currently described, Advanced Basel Banks would be required to implement separate two-dimensional rating systems. For institutions with a comprehensive two-dimensional rating system in place, the Agencies should consider adopting a classification methodology where the “Expected Loss” (EL) is the key factor and mathematically derived in determining how to bucket facilities into the regulatory classification categories. Rather than utilize a grid-based approach, we recommend that the framework use the calculated EL to directly categorize exposures into the regulatory definitions. This will ensure consistency of the regulatory classification with the underlying default probability and loss given default estimates.

- **Borrower Rating Labels & Definitions**: In the proposal, the Borrower rating definitions of “Marginal”, “Weak” and “Default”, at a fundamental level, are essentially unchanged from the current definitions of “Special Mention”, “Substandard” and “Doubtful”. The proposed definitions for the new ratings remain largely a set of judgmental criteria established to rate the borrower’s capacity to meet financial obligations. The Agencies should consider more closely aligning the Borrower rating definitions with the Basel II definition of “Borrower” ratings, which are explicitly tied to the borrower’s probability of default. Furthermore, consideration should also be given to creating benchmark ranges of “default probability” for the regulatory rating categories, much like the proposal currently does for severity along the Facility rating dimension.

Additionally, we see no material benefit of changing the labels for the Borrower ratings. Regardless of the framework chosen, we suggest the ratings maintain their existing labels of Special Mention, Substandard & Doubtful as the added cost related to necessary changes to systems, reporting, policy, procedures, training and communication simply do not add value.

Marginal: Under the current proposal, the definition of "Marginal" covers a wide spectrum of borrower characteristics. It could be a challenge to reconcile BAC’s statistically based Borrower Rating methodology, with a still largely judgmental regulatory approach. We do not see any material gain from re-naming and slightly re-defining this category.

On the other hand, the final paragraph of the “Marginal” definition contains a key change. It states, "The [marginal] rating should also be used for borrowers that have made significant progress in resolving their financial weaknesses, but still exhibit characteristics inconsistent with a ‘Pass’ rating." This enables banks to rate obligors as they move from "well defined weaknesses" to "potential weaknesses". This has been a point of contention among examiners and bankers alike for some time. That is, some believe that a loan could not go from Substandard to Special Mention. BAC endorses this change in philosophy as it more appropriately ties to our methodology with changes in obligor ratings reflective of changing financial profiles.

Weak: The second paragraph of the definition covers illustrative examples..... "Illustrative adverse conditions that may warrant a borrower rating 'weak' include insufficient level of cash flow compared to debt service needs; a highly leveraged balance sheet; a loss of access to capital markets; adverse industry and/or economic conditions that the borrower is poorly

positioned to withstand; *or* a substantial deterioration in the borrower's operating margins". BAC understands the intent of definition and believes that the conjunction "*or*" regarding operating margin deterioration should be replaced by "and". A decline in operating margins by itself does not necessarily mean that a borrower has well defined weaknesses or pronounced probability of default.

Default - The definition of the default rating in the proposed framework is inconsistent with the Basel II definition of default. The Basel II default definition is broader, including the requirement to consider 90 day past dues as defaulted. It would be unduly confusing to operate in an environment where default had multiple regulatory definitions. We support one consistent definition of "default".

- **Facility / Severity Rating:** In the proposal, facility ratings are required only for borrowers rated Default. For borrowers not rated Default, institutions would have the option of assigning the facility ratings. The agencies believe that this will allow institutions with both one-dimensional and two-dimensional internal risk rating systems to adopt the proposed framework. This "option" deviates from the basic Advanced Basel II requirement to assign a LGD in each situation, whether or not default has occurred. Additionally, if facility ratings are optional for all facilities except defaulted obligors, is the assumption that all other internally reported ratings represent only the likelihood of a borrower defaulting? Currently, our reported internal ratings are all at the Facility Level, which represents an "Expected Loss". As stated earlier, we suggest the Agencies consider a like approach and associate the Facility Risk Rating with the facilities "Expected Loss" vs. only the "Severity".

Additionally, it would be difficult for the Agencies to administer a Shared National Credit (SNC) review if assigning facility ratings are optional and institutions are assigning assets classifications using differing and elective methodologies.

ABL: We understand the Agencies objectives to single out Asset Based Lending (ABL) as this area has often resulted in disagreements between the Regulatory ratings and bank assigned ratings. However, there are other specialized lending and collateral-based loan activities with advance rates, collateral valuations, monitoring, and liquidation characteristics that may justify similar treatment. We recommend that Basel II compliant banks have the option of basing LGD's on their historical loss experience without additional qualifying requirements separately determined by regulatory agencies (such as convertibility, coverage, control, etc...). We also believe banks should be able to rate a qualifying Marginal/Low Severity ABL exposure as Pass.

The proposal's "Remote" Facility Rating carries a severity factor of "0". This is unusual and inconsistent with even the lowest "severity" factors at virtually all banks. This appears to be due to how Loss Severity is to be calculated in this proposal (Gross Investment), which is also inconsistent with the guidance on calculating severity in the Basel II Accord.

Response to Questions in Proposal:

1. *The agencies intend to implement this framework for all sizes of institutions. Could your institution implement the approach?*
 - If required, we could implement this approach, although we do not endorse these changes as currently proposed. Bank of America would incur substantial costs associated with implementing this proposal. Prior to endorsing the proposal, we would want to see closer alignment with the pending Basel II Accord requirements, as well as consideration given to other suggestions contained within this response letter. Please see comments and recommendations above.

2. *If not, please provide the reasons:* N/A
3. *What types of implementation expenses would financial institutions likely incur? The agencies welcome financial data supporting the estimated cost of implementing the framework.*
 - No matter what new framework is chosen, we recognize that there will be associated implementation costs. However, BAC would incur numerous and significant implementation expenses with this proposal, including required system changes, reporting changes, process changes, policy changes, and costs associated with new and comprehensive training and communications. We would prefer to limit these costs only to areas where value would be added.
4. *Which provisions of this proposal, if any, are likely to generate significant training and systems programming costs?*
 - New borrower and facility rating definitions.
 - Managing certain data (such as default definition and severity) one way for Basel II and another way for this proposal.
5. *Are the examples clear and the resultant ratings reasonable?*
 - The examples presented in the proposal are generally helpful in the overall explanation of the proposed changes to the Regulatory definitions. However, the examples used were fairly simplistic and may not provide sufficient insight into many of the common complexities of assigning the proposed definitions. Consideration should be given to adding examples to illustrate other types of common collateral and guarantor situations. We appreciate the attempt to NOT be overly prescriptive in the wording of the examples, but we do suggest some elaboration to include numerical values when describing financial measures vs. using broadly generic language. For example, example #1 one contains a certain financial profile of breakeven operations, moderate leverage and moderate liquidity. Because this is so generic and the moderate liquidity and leverage can be interpreted in many different ways, this example may fit many borrowers in both a Pass rating and a Marginal rating.
6. *Would additional parts of the framework benefit from illustrative examples?*
 - Yes. Examples covering fixed assets, inventory, real estate and other collateral. Also, an example covering substitution of a guarantor rating in lieu of the obligor rating.
7. *Is the proposed treatment of guarantors reasonable?*
 - The treatment of unconditional guaranties also needs to be harmonized with the Basel treatment such that the eligibility requirements for substitution are clear, consistent, and would not require multiple methodologies for identifying, tracking, and evaluating the eligibility requirements.
 - The proposed treatment of guarantors in unrelated entity situations is not reasonable. The substitution approach fails to recognize that both the borrower and guarantor would have to default in order to cause an economic loss to the bank. Mathematically, the probability of a double default for unrelated entities is much lower than that of the guarantor on a standalone basis. Because the substitution approach simply replaces the borrower rating with that of the guarantor, this important double default effect is not captured and understates the risk mitigation value of guarantees.
- (8) *Please provide any other information that the agencies should consider in determining the final policy statement, including the optimal implementation date for the proposed changes.*
 - Optimal implementation would be post-Basel II implementation. This will ensure harmonizing and consistency with Basel II, while also reducing implementation costs.
 - As stated above, for institutions with a comprehensive two-dimensional rating system in place,

the Agencies should consider adopting a classification methodology where the “Expected Loss” (EL) is the key factor in determining how to bucket facilities into the regulatory classification categories. This methodology incorporates the same principles (PD & LGD) as the Agencies’ proposal, but may be easier to implement.

Summary:

While Bank of America largely supports the intentions of the proposal; we remain concerned by several aspects as documented above. We thank you for your consideration of the foregoing and hope to continue working with the Agencies to address our questions and concerns and eventually develop and implement a two-tiered regulatory classification system.

Sincerely,

A handwritten signature in black ink, appearing to read "Kevin Shannon". The signature is fluid and cursive, with the first name "Kevin" being more prominent than the last name "Shannon".

Kevin Shannon
Risk Management Executive
Bank of America Corporation